

COCHISE HEALTH SYSTEMS

Financial Statements

and

Supplemental Information

September 30, 2011

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Fester & Chapman P.C.

Certified
Public
Accountants

4001 North 3rd Street
Suite 275
Phoenix, AZ 85012-2086

Tel: (602) 264-3077
Fax: (602) 265-6241

Independent Auditors' Report

To the Board of Supervisors of
Cochise County, Arizona

We have audited the accompanying financial statements of Cochise Health Systems (the Plan), a proprietary fund of Cochise County, Arizona, as of and for the three months ended September 30, 2011, as listed in the table of contents. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only Cochise Health Systems and do not purport to, and do not, present fairly the financial position of Cochise County, Arizona, as of September 30, 2011, and the changes in its financial position, or, where applicable, its cash flows for the three months then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Cochise Health Systems as of September 30, 2011, and the changes in its financial position and cash flows for the three months then ended in conformity with U.S. generally accepted accounting principles.

Our audit was made for the purpose of forming an opinion on the basic financial statements of the Plan taken as a whole. The accompanying supplemental information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Fester & Chapman P.C.

February 1, 2012

Cochise Health Systems

STATEMENT OF NET ASSETS
ENTERPRISE FUND

September 30, 2011

ASSETS

Current assets:

Cash and cash equivalents	\$ 6,072,509
Reinsurance receivable	304,544
Capitation and reconciliations receivable	<u>224,322</u>
Total current assets	6,601,375

Noncurrent assets:

Capital assets:

Furniture, equipment and vehicles	122,024
Accumulated depreciation	<u>(101,050)</u>
	<u>20,974</u>

Total assets	<u>6,622,349</u>
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LIABILITIES AND NET ASSETS

Current liabilities:

AHCCCS member care liabilities	3,182,866
Accrued payroll and related expenses	<u>149,415</u>
Total current liabilities	<u>3,332,281</u>

Net assets:

Invested in capital assets	20,974
Restricted for health care	1,434,000
Unrestricted	<u>1,835,094</u>
Total net assets	<u>\$ 3,290,068</u>

The accompanying notes are an integral part of this statement.

Cochise Health Systems

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
ENTERPRISE FUND

Three Months Ended September 30, 2011

Operating revenues:

Capitation and share of cost reconciliation	\$ 7,789,809
Reinsurance	399,202
Patient contributions	5,170
Other	<u>25,650</u>
Total operating revenues	<u>8,219,831</u>

Operating expenses:

Acute care:

Hospitalization	167,688
Primary care physician	82,263
Outpatient facility	85,374
Referral physician services	107,955
Pharmacy	151,872
Lab and radiology	45,596
Transportation	211,614
Therapies	27,916
Emergency services	70,778
Durable medical equipment	121,273
Outpatient behavioral health	27,071
PPC acute care	5,589
Dental	906
Other acute care costs	<u>2,593</u>
Total acute care	<u>1,108,488</u>

Institutional care:

Nursing home ICF and bedholds	1,923,054
SNF Level I	1,277,704
SNF Level II	344,794
SNF Level III	322,478
Institutional care	74,164
PPC institutional expenses	<u>54,406</u>
Total institutional care	<u>3,996,600</u>

(Continued)

The accompanying notes are an integral part of this statement.

Cochise Health Systems

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
ENTERPRISE FUND

Three Months Ended September 30, 2011
(Continued)

Home and community based services:	
Home health nurse	\$ 77,880
Personal care	41,636
Homemaker	9,716
Home delivered meals	29,340
Respite care	2,833
Attendant care	1,136,621
Assisted living in-home	276,204
Adult foster care	36,831
Environmental modifications	1,995
Assisted living center	189,445
Other HCBS	3,866
PPC HCBS	9,244
Total home and community based services	<u>1,815,611</u>
Case management:	
Case management payroll and payroll related	314,821
Case management, other	<u>5,605</u>
Total case management	<u>320,426</u>
Total medical expenses	<u>7,241,125</u>

(Continued)

The accompanying notes are an integral part of this statement.

Cochise Health Systems

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
ENTERPRISE FUND

Three Months Ended September 30, 2011
(Continued)

Administration expenses:	
Administrative payroll and payroll related	\$ 367,883
Data processing	36,000
Professional fees	7,798
Occupancy	216
Other	186,609
Depreciation	<u>2,697</u>
Total administration expenses	601,203
Total operating expenses	<u>7,842,328</u>
Operating income	377,503
Nonoperating revenues (expenses)	
Interest income	11,435
Premium tax	<u>(171,042)</u>
Total nonoperating revenues (expenses), net	<u>(159,607)</u>
Increase in net assets	217,896
Total net assets, July 1, 2011	<u>3,072,172</u>
Total net assets, September 30, 2011	<u>\$ 3,290,068</u>

The accompanying notes are an integral part of this statement.

Cochise Health Systems

STATEMENT OF CASH FLOWS
ENTERPRISE FUND

Three Months Ended September 30, 2011

Cash flows from operating activities:	
Cash received from:	
Contractors, patients, and other payors	\$ 8,537,544
Miscellaneous operations	19,687
Cash payments to:	
Providers for health care services	(6,810,141)
Suppliers for goods and services	(428,930)
Employees for services	<u>(699,400)</u>
Net cash provided by operating activities	618,760
Cash flows from noncapital financing activities:	
Premium tax payments	<u>(171,042)</u>
Net cash used for noncapital financing activities	(171,042)
Cash flows from investing activities:	
Interest received on cash and cash equivalents	<u>11,435</u>
Net cash provided by investing activities	<u>11,435</u>
Net increase in cash and cash equivalents	459,153
Cash and cash equivalents at July 1, 2011	<u>5,613,356</u>
Cash and cash equivalents at September 30, 2011	<u>\$ 6,072,509</u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 377,503
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation	2,697
Changes in assets and liabilities:	
Reinsurance receivable	381,836
Receivable from AHCCCS	(33,303)
AHCCCS member care liabilities	116,166
Accounts payable and accrued administrative expenses	<u>(226,139)</u>
Total adjustments	<u>241,257</u>
Net cash provided by operating activities	<u>\$ 618,760</u>
Supplemental disclosure:	
Interest paid	none

The accompanying notes are an integral part of this statement.

Cochise Health Systems

NOTES TO FINANCIAL STATEMENTS

September 30, 2011

NOTE 1 - GENERAL PLAN DESCRIPTION

The financial statements presented are for Cochise Health Systems (the Plan), which is a division of Cochise County Department of Aging and Social Services. No other County operations are included in these financial statements. The Plan is party to an Arizona Long-Term Care System (ALTCS) contract for Cochise County residents that was awarded to Cochise County on November 1, 1993, and the Graham and Greenlee Counties' ALTCS contracts that were awarded to Cochise County on December 13, 1999, and October 1, 2001, respectively. These contracts are administered under the auspices of the Arizona Health Care Cost Containment System (AHCCCS). The Plan provides acute medical care, long-term institutional care, and home and community based services for physically disabled and elderly persons who are AHCCCS members and are at risk of institutionalization.

NOTE 2 – TERMINATION OF AHCCCS CONTRACT

The Plan received notice in May 2011 that its AHCCCS contract that expired in September 2011, would not be renewed. The contract provided 99% of the Plan's revenue during the year ended June 30, 2011. Therefore, starting in October 2011, the Plan no longer is earning capitation revenue and has limited its operations to processing and paying claims. The Plan intends to pay authorized claims through September 30, 2012 as required by the terms of the expiring contract.

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Fund

A Fund is described as an independent fiscal and accounting entity with a self-balancing set of accounts used to record assets, related liabilities, reserves and equities which are segregated for the purpose of carrying on activities of the reporting entity.

Proprietary (Enterprise) Fund

This fund type is used to account for operations that are financed and operated in a manner similar to private business enterprises, in which the intent is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

Cochise Health Systems

NOTES TO FINANCIAL STATEMENTS - CONTINUED

September 30, 2011

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTANT POLICIES – CONTINUED

Basis of Accounting

The financial statements were prepared using the accrual basis of accounting, following accounting principles U.S. generally accepted accounting principles as they apply to enterprise funds of state and local governments, and following the reporting guidelines as established by AHCCCS.

Pronouncements of GASB and FASB

Government Accounting Standards Board (GASB) Statement No. 20 states that Financial Accounting Standards Board (FASB) and its predecessor body pronouncements issued before November 30, 1989, continue to be applicable to Enterprise Funds unless they conflict with or contradict GASB guidance.

Enterprise Funds may take either of the following approaches to FASB guidance issued subsequent to November 30, 1989.

1. An entity may elect to continue to follow FASB guidance that does not conflict with or contradict GASB guidance. If this election is made, it must be followed consistently. It would not be appropriate to follow some FASB pronouncements issued subsequent to the cutoff date, but not others.
2. An entity may elect not to subject itself to FASB guidance issued subsequent to the cutoff date. In that case, even FASB amendments of guidance issued prior to the cutoff date would not be applicable to proprietary operations.

The Plan has elected to subject itself to FASB guidance issued subsequent to November 30, 1989.

Use of Estimates

In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cochise Health Systems

NOTES TO FINANCIAL STATEMENTS - CONTINUED

September 30, 2011

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTANT POLICIES - CONTINUED

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Plan considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. All of the Plan's monies are under the direct supervision of the Cochise County Treasurer's Office and were fully collateralized or invested in the Arizona State Treasurer's Local Government Investment Pool (LGIP).

Revenue Recognition

a. Capitation Revenue

The Plan receives capitation payments under the AHCCCS contract based on member months equivalents. At the beginning of each month, the Plan receives capitation based on the number of members enrolled for that month. As members are added or removed from enrollment, capitation is adjusted for the remaining portion of the month. At any given time, capitation may be due to or due from AHCCCS. Capitation revenue is recognized in the month that members are entitled to long-term and acute health care services. The Plan is required to provide those services to its members, regardless of the cost of care provided.

b. Reinsurance Revenue

The Plan is entitled to receive reinsurance revenue from AHCCCS for a percentage of costs incurred for in-patient hospital care and certain other medical expenses in excess of a stated deductible per member per contract year.

c. Share of Cost Adjustment

Per the contract with AHCCCS, members with income in excess of standards set by AHCCCS are to pay a portion of their covered expenses. This is known as a Share of Cost (SOC). A portion of the Plan's capitation is based on assumed SOC per member per month. If actual assigned SOC is less than assumed SOC, AHCCCS has agreed to reimburse the Plan. If actual assigned SOC is greater than assumed SOC, the Plan has agreed to reimburse AHCCCS. The SOC adjustment is based on current assigned SOC information from AHCCCS.

Cochise Health Systems

NOTES TO FINANCIAL STATEMENTS - CONTINUED

September 30, 2011

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTANT POLICIES - CONTINUED

Furniture, Equipment and Vehicles

Furniture, equipment and vehicles in excess of \$5,000 are recorded at cost and depreciated using straight-line and accelerated methods over the estimated useful lives of the assets ranging from 3-7 years.

Income Taxes

The Plan is a division of a governmental entity, and as such does not pay income taxes. Therefore, no provision for income taxes has been made in these statements.

Medical Expenses

All medical expenses are reported net of Medicare payments.

NOTE 4 - BONDING MECHANISM

On September 20, 1993, the Cochise County Board of Supervisors adopted Resolution 93-99 pledging to provide financial backing as an ALTCS program contractor, in the event of a default by the Plan. On November 22, 1999, the Cochise County Board of Supervisors adopted Resolution 99-80 amending Resolution 93-99 to include the addition of Graham County in the Cochise County ALTCS program service area. Effective October 1, 2001 Resolution 01-61 was adopted by the Board of Supervisors amending the previous resolutions to include Greenlee County.

NOTE 5 - RETIREMENT PLAN

Plan Description

The Plan contributes to the Arizona State Retirement System (ASRS), which administers a cost-sharing multiple-employer defined benefit pension plan that covers general employees of Cochise County. The ASRS is governed by the Arizona State Retirement System Board according to the provisions of A.R.S. Title 38, Chapter 5, Article 2. Benefits are established by state statute and generally provide retirement, death, long-term disability, survivor, and health insurance premium benefits.

Cochise Health Systems

NOTES TO FINANCIAL STATEMENTS - CONTINUED

September 30, 2011

NOTE 5 - RETIREMENT PLAN-CONTINUED

The ASRS issues a publicly available financial report that includes its financial statements and required supplementary information. A report may be obtained by writing or calling:

ASRS

3300 N. Central Avenue

P.O. Box 33910

Phoenix, AZ 85067-3910

(602) 240-2000 or (800) 621-3778

Funding Policy

The Arizona State Legislature establishes and may amend active plan members' and the Plan's contribution rates.

For the ASRS fiscal year ended June 30, 2011, active ASRS members and the Plan were each required by statute to contribute at the actuarially determined rate of 9.85 percent (9.6 percent retirement and 0.25 percent long-term disability) of the members' annual covered payroll. The Plan's contributions to ASRS for the years ended June 30, 2011, 2010 and 2009 were \$197,823, \$184,282 and \$175,615, respectively, which was equal to the required contributions for each respective year.

NOTE 6 – CAPITAL ASSETS

Capital asset activity for the three months ended September 30, 2011, was as follows:

	Beginning Balance	Increases	Ending Balance
Furniture and equipment	\$ 45,093		\$ 45,093
Vehicles	76,931		76,931
Less accumulated depreciation	(98,353)	\$ (2,697)	(101,050)
Total capital assets, net	<u>\$ 23,671</u>	<u>\$ (14,965)</u>	<u>\$ 20,974</u>

Cochise Health Systems

NOTES TO FINANCIAL STATEMENTS - CONTINUED

September 30, 2011

NOTE 7 – CLAIMS PAYABLE

The Plan utilizes a computerized authorization system to aid in the determination of received but unpaid claims (RBUCs) and to prevent unauthorized services from being rendered. Providers are required to obtain authorization before services are rendered for most services provided. The Plan then uses historical analysis reports from their computer system to generate lag reports. These lag reports are used to estimate incurred but not reported claims (IBNRs). IBNRs are then added to RBUCs to determine claims payable. In addition, incentives of up to 2% of claims paid to institutional care providers can be earned and are accrued as claims payable.

Claims payable at September 30, 2011, consisted of the following:

Medical claims payable	\$ 3,137,866
Prior period coverage payable	5,000
Institutional care incentives	<u>40,000</u>
Total claims payable	<u>\$ 3,182,866</u>

NOTE 8 - RESTRICTED NET ASSETS

Per the contract with AHCCCS, the Plan is required to retain in equity an amount equal to \$2,000 per enrolled member at year-end. Restricted net assets totaled \$1,434,000 at September 30, 2011. The balance of any equity may be distributed after the issuance of the audited financial statements, with AHCCCS's permission. During the three months ended September 30, 2011, the Plan did not transfer any funds to Cochise County's general fund.

NOTE 9 - OTHER ADMINISTRATION

Following is a summary of other administration expenses for the three months ended September 30, 2011:

Office supplies	\$ 3,060
Insurance	14,964
Telephone	3,172
County overhead	157,956

Cochise Health Systems

NOTES TO FINANCIAL STATEMENTS - CONTINUED

September 30, 2011

NOTE 9 - OTHER ADMINISTRATION - CONTINUED

Postage	1,734
Consulting	200
Equipment lease	5,319
Other	<u>204</u>
	<u>\$ 186,609</u>

NOTE 10 - RELATED PARTY TRANSACTIONS

The Plan incurred administration fees from Cochise County of \$157,956 for the three months ended September 30, 2011. The Plan's employees are employees of the County and are subject to all rules and regulations of Cochise County.

NOTE 11 - RECONCILIATIONS RECEIVABLE FROM/(PAYABLE TO) AHCCCS

The amounts due from AHCCCS at September 30, 2011, are as follows:

Share of cost	<u>\$ 224,322</u>
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NOTE 12 - SUBSEQUENT EVENTS

The Plan has evaluated subsequent events through February 1, 2012, the date which the financial statements were available to be issued, and has concluded that no events have occurred since the three months ended September 30, 2011 that would require an adjustment to or disclosure in the financial statements.